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MOTION FILED
SEP 5 1989

No. 88-1474

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

UNITED STATES OF AMERICA,

Petitioner,

v.

THE GOODYEAR TIRE & RUBBER COMPANY AND AFFILIATES,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Federal Circuit

MOTION OF VULCAN MATERIALS COMPANY FOR LEAVE TO FILE BRIEF *AMICUS CURIAE* IN SUPPORT OF RESPONDENT AND BRIEF OF *AMICUS CURIAE* IN SUPPORT OF RESPONDENT

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September 5, 1989

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40 pp

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Vulcan Materials Company ("Vulcan") hereby respectfully moves for leave to file the attached brief *amicus curiae* in this case. The consent of the attorney for Petitioner has been obtained and is filed herewith. The consent of the attorney for Respondent was requested, but the attorney for Respondent declined to consent.

The interest of Vulcan in this case arises from the fact that it is a party to a case presently pending in the United States Tax Court, *Vulcan Materials Company v. Commissioner*, T.C. Docket No. 11680-88, in which a similar issue is presented, namely, whether foreign corporate income

tax law should be taken into account in determining the meaning of "accumulated profits" for purposes of the indirect foreign tax credit. The applicable foreign law in that case imposes corporate income tax on *only* a U.S. shareholder's allocable portion of the profits of a local corporation owned by both nationals of the foreign country and U.S. residents. In the pending Tax Court case, Vulcan's position is that this aspect of foreign tax law must be recognized, and the term "accumulated profits" must be interpreted as including only that proportion of profits actually subject to foreign corporate income tax. The Commissioner of Internal Revenue (the "Commissioner"), by contrast, takes the same position in the pending Tax Court case that he took in Revenue Ruling 87-14, 1987-1 C.B. 181, namely, that the term "accumulated profits" cannot be determined by reference to foreign law because the term "accumulated profits" is defined *solely* by reference to U.S. corporate income tax law. The Commissioner's position in Revenue Ruling 87-14 is the essence of Petitioner's position in the instant case, although the setting is different.

In the instant case in the Court of Appeals, there was considerable discussion by both Petitioner and Respondent concerning the legislative history of the term "accumulated profits" in the indirect foreign tax credit provisions. Nevertheless, significant omissions exist in that discussion, especially with respect to the legislative history and evolution of those provisions in U.S. tax laws *prior* to the Revenue Act of 1921, ch. 136, 42 Stat. 259. The brief that Vulcan is requesting permission to file as *amicus curiae* contains a complete analysis of the relevant sections of that prior legislative history and reveals a critical aspect, which has not been previously addressed by either Petitioner or Respondent.

Moreover, because of Vulcan's concern that Petitioner's position herein, if upheld by this Court, will automatically apply to other factual and legal settings, Vulcan believes that the brief it is requesting leave to file as *amicus curiae* contains analyses of such settings that are not likely to be addressed by either Petitioner or Respondent in the

instant case. Vulcan therefore moves for leave to file a brief *amicus curiae* because it believes that the brief will assist this Court in reaching the proper result in this case.

Respectfully submitted,

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**On Writ Of Certiorari To
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For The Federal Circuit**

BRIEF OF VULCAN MATERIALS COMPANY AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENT

Vulcan Materials Company respectfully submits this brief as amicus curiae in support of the Goodyear Tire & Rubber Company and Affiliates.

INTEREST OF THE *AMICUS CURIAE*

Vulcan Materials Company ("Vulcan"), a New Jersey corporation with its principal place of business in Birmingham, Alabama, is engaged in the production and sale of construction materials, chemicals, metals and related products.

Vulcan's interest in this case arises from the fact that it is a party to a pending United States Tax Court case,

Vulcan Materials Company v. Commissioner, T.C. Docket No. 11680-88, challenging the validity of Revenue Ruling 87-14.[1] Vulcan believes that the decision in this case may have a direct effect upon the outcome of its Tax Court case.

SUMMARY OF ARGUMENT

In arguing that foreign law must be disregarded totally in determining "accumulated profits," Petitioner has misread the legislative history, ignored its own counsel, and has assumed an inflexible position that frustrates Congress' purpose in enacting section 902 of the Internal Revenue Code (the "Code").[2]

Petitioner has not answered and cannot answer one simple question: Why did Congress purposefully avoid equating "accumulated profits" (and its precursors) with "earnings and profits" (and its precursors) when the earliest version of the indirect foreign tax credit was enacted, and when substantive changes were later made?

Petitioner's insistence that total disregard of foreign tax law is the sole means of achieving the purposes of the section 902 credit is wrong. Such total disregard produces the very results Petitioner decries—double taxation and lack of equivalent tax treatment of branches and subsidiaries. Moreover, in recent regulations and in interpreting section 902 under the U.S.-U.K. Tax Treaty, Petitioner has actually admitted that a rigid disregard of foreign law is incorrect.

Finally, Petitioner asserts that only its position can avoid opening up a Pandora's box of "vagaries of foreign law," implying that courts cannot take into account that law as necessary. To the contrary, courts have done so when dealing with other aspects of the foreign tax credit, as

[1] 1987-1 C.B. 181.

[2] Unless otherwise indicated, all statutory references are to the Internal Revenue Code of 1954, as amended and in effect during the years at issue.

has Congress, and even, on occasion, the Internal Revenue Service ("IRS").

Congress intended that the indirect foreign tax credit be applied so as to avoid double taxation. Petitioner suggests a wholly inflexible rule that will frustrate Congress' purpose. This Court should not hold that foreign law can never be taken into account in determining "accumulated profits" for purposes of section 902.

ARGUMENT

I. PETITIONER INCORRECTLY ARGUES THAT THE TERM "ACCUMULATED PROFITS" IS SYNONYMOUS WITH THE TERM "EARNINGS AND PROFITS" AND IS TO BE COMPUTED TOTALLY WITHOUT REGARD TO THE OPERATION OF FOREIGN TAX LAW.

By framing the issue as whether "accumulated profits" under section 902(a) are to be computed under U.S. or foreign tax law,[3] Petitioner "focuses its beam on the wrong spot"[4] and thus would lead this Court to the wrong result.

Petitioner urges the Court to utilize this case as an occasion to resolve all conflicts between the laws of the U.S. and of foreign countries regarding the determination of "accumulated profits" in favor of the preemptive application of "U.S. tax rules." Such a result would follow directly from the holding, urged by Petitioner, that the term "accumulated profits" as used in section 902 is syn-

[3] Petitioner's Brief ("Pet. Br.") at 4.

[4] Dale, *The Reformed Foreign Tax Credit: A Path Through the Maze*, 33 Tax L. Rev. 175 (1978), where certain source rule amendments, enacted in 1976, are compared to "the drunk searching at night under a street lamp. Asked what he was looking for, he replied it was his watch, which he had lost in the adjacent park. When further queried why he was looking under the street lamp if the watch had been lost elsewhere, he answered, 'Because the light is better here.' " *Id.* at 195.

onymous with the term "earnings and profits" as used in section 316.[5]

The issue in this case, however, is much narrower than Petitioner suggests: Whether the accumulated profits from which a dividend is paid by a foreign subsidiary should be "sourced" in either (i) the same taxable year in which foreign taxes actually were imposed on such profits, or (ii) in a different taxable year in which U.S. taxes would have been imposed on such profits had they been earned by a domestic corporation.[6] Stated differently, the issue presented here is a sourcing or "ordering" issue, not a definitional issue.

The sole issue in dispute is in which year the accumulated profits from which the dividend was paid should be sourced. If the profits are sourced in a *prior* year, consistent with foreign law ordering rules, then a credit should be allowed for such prior year's taxes. If the profits are sourced in the *current* year, consistent with U.S. law ordering rules (as if the foreign subsidiary were a domestic corporation), then no credit should be allowed if no foreign taxes were paid in that year.

Even if we follow Petitioner's beam to the wrong spot, and view the issue as a definitional issue, rather than an ordering issue, an examination of the statutory definition

[5] Pet. Br. at 25. Petitioner does concede the existence of narrow definitional differences between the two terms, such as the fact that "accumulated profits" is an annual concept, requiring identification of the particular taxable year or years in which such profits have been accumulated—an "ordering" or "sourcing" exercise with respect to an amount which is used for no other purpose under the Code than the calculation of the section 902(a) fraction—whereas "earnings and profits" is an aggregate or cumulative concept, denoting the totality of the multi-year fund of profits and surplus available for distribution as a dividend. Pet. Br. at 25 n.11. Within a single taxable year, the terms are, in Petitioner's view, otherwise synonymous. *But see Goodyear Tire & Rubber Co. v. United States*, 14 Cl. Ct. 23, 28 (1987), *rev'd*, 856 F.2d 170 (Fed. Cir. 1988) (denying the equivalence of the two terms).

[6] Respondent has similarly framed the issue. Respondent's Brief in Opposition 3-6.

of "accumulated profits," and of its legislative history, strongly suggests that the definition urged here by Petitioner is wrong. Equally important, Petitioner's rigid equation of "accumulated profits" with "earnings and profits," if ever accepted, would operate to preclude the ability to reach pragmatic solutions in section 902 cases—in the words of the Tax Court in *Champion*, "sensible results"—in this area "fraught with complex definitional concepts and requiring the meshing of U.S. tax laws with those of foreign countries."[7]

A. Legislative History.

From 1921[8] until 1986,[9] U.S. tax law defined "accumulated profits" as "the amount of gains, profits, or income in excess of the income, war-profits, and excess-profits taxes imposed upon or with respect to such profits or income." The Court of Appeals in the decision below concluded that the "plain meaning" of this statutory phrase was the income of the foreign subsidiary on which the taxes are imposed, net of the taxes imposed.[10] Since the relevant taxes are imposed by a foreign jurisdiction, and since the relevant income is that on which the foreign jurisdiction imposes the taxes, it is not illogical to conclude that the income in question is the foreign tax base. To reject such a plain meaning interpretation, something more should be required than Petitioner's conclusory and cavalier reference to its own regulations.[11] Even unassisted

[7] *Champion Int'l Corp. v. Commissioner*, 81 T.C. 424, 436-437 (1983), *acq.*, 1984-1 C.B. 1.

[8] Revenue Act of 1921, § 238(e), ch. 136, 42 Stat. 259.

[9] Section 1202(a) of the Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2528, substituted the term "post-1986 undistributed earnings" for "accumulated profits" and generally eliminated the issue presented in this case for post-1986 years.

[10] *Goodyear Tire & Rubber Co. v. United States*, 856 F.2d 170, 172 (Fed. Cir. 1988), *rev'g* 14 Cl. Ct. 23 (1987).

[11] Pet. Br. at 33, referring to Treas. Reg. § 1.902-3(c)(1) (1965) (now Treas. Reg. § 1.902-1(e)), which defines accumulated profits to mean "the sum of (i) the earnings and profits of such corporation for such

logic would cause one to question why accumulated profits should be equated with U.S. earnings and profits which, in addition to not being the base on which the foreign taxes are imposed, is not even the base upon which U.S. taxes are imposed.

Nevertheless, it is this odd-seeming equation between accumulated profits and earnings and profits that Petitioner asks this Court to adopt. Failure to so define the term, Petitioner argues, will result in disparate treatment for foreign subsidiaries and branches.[12] While there is a sound answer to this argument, as discussed below, a critical point should be noted initially which Petitioner *fails* to argue. Petitioner fails to argue that Congress unambiguously intended to define accumulated profits as synonymous with U.S. earnings and profits. Unable to assert credibly this argument, Petitioner implies that Congress, in enacting the above-quoted statutory definition of accumulated profits, was either wrong or unintentionally vague in formulating its definition.

Examination of the legislative history of section 238(e) of the Revenue Act of 1921, ch. 136, 42 Stat. 259, the combined predecessor of both section 902(a) and section 902(c)(1), reveals that Congress was quite deliberate and precise in its use of terminology in that provision. If any mistake has been made, therefore, it is not Congress', but Petitioner's, in failing to interpret the statute in accordance with its terms and, to compound the error, in failing to heed the advice of an IRS Chief Counsel's memorandum[13] that the regulatory definition be modified so as to achieve the intended coordination of foreign and domestic law.

Section 238(e) was enacted to correct a serious defect in section 240(c) of the Revenue Act of 1918, ch. 18, 40

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year, and (ii) the foreign income taxes imposed on or with respect to the gains, profits and income to which such earnings and profits are attributable."

[12] Pet. Br. at 11, 14-15.

[13] G.C.M. 36814 (Aug. 18, 1976), discussed at Pt. I, Sec. B., *infra*.

Stat. 1082, the earliest predecessor of modern section 902. Section 240(c) allowed an indirect foreign tax credit that was computed by multiplying foreign taxes paid during the taxable year by the fraction of dividends over "total taxable income" of the foreign corporation for such year. The amount of the credit was limited to the amount of the dividend.

Two aspects of section 240(c) are significant here. First, Congress elected to use as the formula's denominator a term, "taxable income," *that was not used anywhere else in the Revenue Act of 1918* (nor in the Revenue Acts of 1913, 1916, 1917 or 1921) *and had no other generally accepted tax law meaning during that period.* Had Congress intended a U.S. concept of taxable income (in the modern, section 63 sense), the proper term to describe that concept was close at hand: The Revenue Act of 1918, like the Revenue Acts of 1913, 1916, 1917 and 1921, used the term "net income" to describe the U.S. corporate tax base (gross income less allowable deductions).[14] That the term "net income" was not used in section 240(c) thus cannot be ascribed to inadvertence. Rather, it was a deliberate choice *not* designed to ensure the foreign mirror image of U.S. net income. Indeed, the Court of Appeals for the Second Circuit, in *United Dyewood Corp. v. Bowers*,[15] considered it "entirely clear" that the term "taxable income" in the 1918 Act meant "the sum used by the foreign government as a base to compute the foreign tax."

The second significant aspect of section 240(c) is that its use of a "taxable income" denominator operated to limit the indirect credit to foreign taxes paid in the foreign corporation's current taxable year. Section 240(c) thus lacked a mechanism for sourcing to a prior year the earnings from which a dividend was paid. Unless the foreign

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[14] Revenue Act of 1913, ch. 16, § G.(a), 28 Stat. 172; Revenue Act of 1916, ch. 463, § 10, 39 Stat. 765; Revenue Act of 1917, ch. 63, § 10(a), 40 Stat. 333; Revenue Act of 1918, ch. 18, § 230(a), 40 Stat. 1075; Revenue Act of 1921, ch. 136, § 230, 42 Stat. 252.

[15] 56 F.2d 603 (2d Cir. 1932).

subsidiary remitted all of its earnings annually, a credit for some portion of the foreign taxes paid on its prior year earnings would be permanently lost and double taxation would result.[16]

Section 238(e) of the Revenue Act of 1921 remedied this problem by substituting the term "accumulated profits" for "taxable income" as the denominator of the indirect credit fraction. The clear intent of this change was to permit earnings out of which the foreign subsidiary's dividend was paid to be sourced in a prior year, and to permit credits to be claimed for foreign taxes paid on such earnings when distributed in a later year. It is this change that provides equivalent treatment for branches and subsidiaries,[17] and thus achieves the legislative purpose.

Petitioner, remarkably, does not dispute this point.[18] But it is a point that gravely undermines its position. The 1921 Act's use of "accumulated profits" was intended to create

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[16] As explained in *American Chicle Co. v. United States*, 316 U.S. 450, 453 (1942): "The difficulty with [section 240(c)] was that it did not relate the credit to the accumulated profits or surplus of the subsidiary out of which the dividends were paid."

[17] As noted by Senator Smoot, the amendment's sponsor:

> In such a case a foreign subsidiary is much like a foreign branch of an American corporation. If the American corporation owned a foreign branch, it would include the earnings or profits of such branch in its total income, but it would also be entitled to deduct from the tax based upon such income any income or profits taxes paid to foreign countries by the branch in question. Without special legislation, however, no credit can be obtained where the branch is incorporated under foreign law.

61 Cong. Rec. 7184 (1921). *See also Internal Revenue: Hearings on H.R. 8245 before the Senate Committee on Finance*, 67th Cong., 1st Sess. 389 (1921) (statement of Dr. Adams, U.S. Department of Treasury).

[18] Pet. Br. at 26-32. The point is of course well-acknowledged elsewhere. *See Goodyear Tire & Rubber Co. v. United States*, 14 Cl. Ct. 23, 30 (1987), *rev'd*, 856 F.2d 170 (Fed. Cir. 1988); *see also Champion Int'l Corp.*, 81 T.C. at 436; *Associated Tel. & Tel. Co. v. United States*, 306 F.2d 824, 827-828 (2d Cir. 1962).

a sourcing mechanism. That sourcing mechanism permitted foreign taxes imposed on prior years' earnings to be released as credits when such earnings were distributed in a later year, rather than being "frozen" in the year paid and thus permanently unrecoverable. The intended parity was thus established between the indirect credit for foreign taxes paid on a foreign subsidiary's profits and the direct credit for foreign taxes paid on a foreign branch's income. Because foreign taxes on branch income are by definition foreign taxes imposed on the income of the U.S. taxpayer itself, they are of course not susceptible to being "frozen" in the year paid and thus permanently lost as credits. It is precisely this sourcing mechanism, enacted in 1921 to create such parity, which Petitioner would eviscerate in the instant case, thus defeating the Congressional objective.

This is not the only fundamental flaw in Petitioner's reading of the 1921 Act's legislative history. Having failed to recognize Congress' deliberate choice of "taxable income" over U.S. "net income" in the 1918 Act's original formulation, Petitioner compounds the omission by failing to offer any evidence, or even speculation, as to why Congress in the 1921 Act would suddenly have opted for U.S. earnings and profits.

Petitioner further neglects to mention that the term "net income," which was used to describe the U.S. corporate tax base in every tax act from 1913 to 1921, was in fact inserted for the first time by the 1921 Act into the very same indirect credit provision (section 238(e)) which contained the term "accumulated profits." The purpose of inserting that term was to replace the 1918 Act's limitation on the credit (the amount of the dividend) with a separate limitation, measured by the proportion of U.S. tax equal to the ratio of foreign subsidiary dividends to the domestic corporation's "entire net income." This ratio constituted an early version of the modern section 904 limitation.

This newly-created foreign tax credit limitation demonstrates beyond doubt that the Congress that enacted

section 238(e) was entirely capable of specifying the application of U.S. tax concepts where it saw fit. That Congress saw fit to so specify with respect to the denominator of one limitation (*i.e.*, the section 904 limitation), while at the same time not so specifying with respect to the denominator of the other (*i.e.*, the section 902 limitation), utterly negates the possibility of an accidental omission.

Further, had Congress intended for the denominator of the section 902 formula to be U.S. earnings and profits, it could merely have incorporated that term from then-existing terminology. The original predecessor of section 316 of the Code was section 10 of the Revenue Act of 1916, which defined a dividend by reference to "earnings or profits." That original definition was reenacted, without material change, in all successor tax acts, including the Revenue Act of 1921.[19]

Thus, having first used the term "earnings or profits" in 1916 to define a dividend, and having used the term "dividend" as the numerator of the section 902 fraction beginning in 1918, Congress failed to use the term "earnings or profits" to describe the denominator of that fraction in any subsequent tax act. Petitioner's brief is silent as to why, if Congress intended that meaning, it did not merely incorporate that definition into the statute either explicitly or by cross-reference. Petitioner's brief is also silent as to why, if Congress intended the use of a known domestic tax concept, it elected to use for this purpose (as it had in the original 1918 Act version) a specially-defined term that had no predecessor or preexisting meaning in either statutory or nonstatutory tax terminology. Congress' decision not to use parallel terminology compels the conclusion that parallel meanings were not intended.

In *Biddle v. Commissioner*,[20] this Court established a presumption in favor of the application of domestic tax

[19] The disjunctive formulation, "earnings or profits," was replaced by the conjunctive formulation, "earnings and profits," in the 1954 Code. *See* Internal Revenue Code of 1954, § 316(a), Pub. L. No. 83-591, 68A Stat. 3, 98-99.

[20] 302 U.S. 572 (1938).

rules, unless a statute "by express language or necessary implication" compels the opposite conclusion.[21] Petitioner cites *Biddle* for the proposition that Congress generally intends the use of "its own criteria."[22] Ironically, in arguing that the term "accumulated profits" means "U.S. earnings and profits," Petitioner is seeking to attribute to the term a meaning quite different than the one that Congress itself provided. Thus, it is Petitioner, not Respondent, that is attempting to overcome the presumption established in *Biddle* by substituting its own criterion for that of Congress.

B. The Commissioner's Rigid Application of U.S. Tax Concepts in the Section 902 Context.

Historically, the rigid application of U.S. tax concepts in the section 902 context by the Commissioner of Internal Revenue (the "Commissioner") has led to egregious results and has culminated in numerous instances of double taxation. Specifically, the Commissioner, as in the present case, has adopted a totally arbitrary and inflexible position that "U.S. tax law" applies in determining "accumulated profits" for section 902 purposes.

The Commissioner's position with respect to the ordering issue was perhaps best exemplified in the *Champion* case, when he "frankly admitted" that his theory—

> "will under some limited circumstances result in double taxation," the avoidance of which, he concedes, is the "fundamental purpose of the foreign tax credit provisions." He argues, however, that the frustration of the purpose of the foreign tax credit, at least in the "limited circumstances" of this case is "unavoidable from the necessity of adhering to United States legal concepts in computing accumulated profits for purposes of the

[21] 302 U.S. at 578.

[22] Pet. Br. at 12.

denominator of the section 902 of the Code deemed-paid credit fraction."[23]

The Tax Court's response to this position was succinct: "[W]e do not think that 'United States legal concepts' make the imposition of double taxation unavoidable."[24] Petitioner's position is no different in the instant case and deserves a like response.

Is there truly no reasonable method available for carrying out the section 902(c)(1) mandate to order or source among particular years a foreign subsidiary's profits from which a dividend is paid without wholly disassociating such profits from the foreign taxes actually imposed on them? Fortunately, the objective of section 902(c)(1) has not proven an unsolvable mystery to the courts. As observed in *General Foods Corp. v. Commissioner*:

> To properly give effect to the language of [section 902(a)(1) and (c)(1)], . . . it is necessary to relate the tax credit to the particular year or years in which the accumulated profits (from which the dividends were paid) were earned and taxed.[25]

And the court in *H.H. Robertson Co. v. Commissioner*, similarly described the provision's clear objective as follows:

> It is of critical importance to determine the "accumulated profits" of each year, so that they can be matched against the foreign taxes paid for *that* year, and so that such dividends are paid "out of" or "from" such "accumulated profits," a foreign tax credit may properly be computed as a portion (in accordance with the statutory

[23] *Champion Int'l Corp.*, 81 T.C. at 436 n.19.

[24] *Id.*

[25] 4 T.C. 209, 216 (1944).

> formula) of the foreign taxes paid in respect of the "accumulated profits" of *that* year.[26]

The *Champion* court criticized the Commissioner's strict adherence to U.S. concepts in that case. The Commissioner refused to recognize the effect of the Canadian law loss carryback rules for ordering purposes, creating "a distortion in the amount of the 'deemed paid' credit" such that "a portion of the accumulated profits of 1969 could *never* be distributed" and thus the foreign taxes paid thereon could *never* be claimed as credits.[27] Such a rigid and inflexible application of U.S. tax principles, wholly impervious to the policy and purpose of sections 902(a) and (c)(1), could not have been intended and should not be permitted:

> The purpose of U.S. tax principles in the context of section 902 is to establish a correlation between the foreign taxes paid on the foreign subsidiary's accumulated profits of a particular year and the dividends paid from the same year's accumulated profits. To ignore the fact that foreign law computes the tax liability by allowing for loss carrybacks is to assure that this correlation will be lost.[28]

Confronted with the unambiguous directive of section 902(c)(1) and its legislative history, and with the rather clear-eyed guidance contained in nearly half a century of court decisions, it is simply inexplicable why the Commissioner has refused to coordinate the ordering rules of foreign and domestic law in a manner consistent with that legislative directive and judicial guidance—even in the face of compelling evidence that the failure to do so produced double taxation.

Instead of attempting to cure this failure, the Commissioner has actually compounded his error by taking liti-

[26] 59 T.C. 53, 79 (1972), *aff'd*, 500 F.2d 1399 (3d Cir. 1974).

[27] *Champion Int'l Corp.*, 81 T.C. at 434-435.

[28] 81 T.C. at 440.

gating positions (as in *Champion*) and issuing rulings (such as Revenue Ruling 74-550,[29] discussed *infra*) that merely highlight, rather than justify, the inadequacies inherent in his rigid application of U.S. tax principles.

Revenue Ruling 74-550 addressed the ordering issue in connection with a foreign subsidiary's net operating loss, which produced a deficit for U.S. earnings and profits purposes in the affected year, but which arose in a foreign jurisdiction whose laws did not provide for a carryback of the loss.[30] The Ruling held that the deficit had the effect of "zeroing out" U.S. earnings and profits in an earlier year, even though foreign taxes were paid in that year. Under the Ruling's strict adherence to U.S. ordering concepts, no dividend could ever be paid out of the earlier year and, thus, the foreign taxes paid in that year could never be credited against the taxpayer's U.S. tax liability.

Revenue Ruling 74-550 demonstrates that rigid adherence to U.S. tax concepts, in the section 902 context, can leave a portion of the profits actually accumulated by a foreign subsidiary, and a portion of the foreign taxes actually paid on such profits—like the Queen's jam—*permanently inaccessible*:

> "The rule is, jam tomorrow, and jam yesterday—but never jam today."
>
> "It must come sometimes to 'jam today,' " Alice objected.
>
> "No, it can't," said the Queen. "It's jam every other day: today isn't any other day, you know."[31]

It is noteworthy that in 1976, the IRS Chief Counsel, confronting yet another graphic example of the anomalous results that would be produced by rigid application of U.S. ordering rules for section 902 purposes, urged the adoption

[29] 1974-2 C.B. 209.

[30] *Id.*

[31] Lewis Carroll (Charles Lutwidge Dodgson), *Alice's Adventures in Wonderland* 5 (1865).

of ordering rules that would conform to those of foreign law.[32] Specifically, G.C.M. 36814 involved the application of section 902 to a liquidating distribution from the U.K. subsidiary of a domestic corporation.[33] Although the subsidiary had income in excess of losses in the aggregate, its earnings history for the relevant period included profit years, followed by loss (deficit) years, followed by additional profit years. While U.S. ordering rules, as interpreted in Revenue Ruling 74-550, required that the deficit be carried back and offset the profits in earlier years, U.K. law required that the loss be carried forward to succeeding years. The result was that U.S. earnings and profits were entirely offset or significantly reduced in the years in which the U.K. levied tax. Conversely, there was little or no U.K. tax in the years in which the U.S. recognized earnings and profits.

On a more extreme version of these facts, the same overlapping application of U.S. and U.K. ordering rules could have produced a situation in which the U.S. deficit offset all the earnings and profits of prior years, while the U.K. loss carryforward produced a total refund of U.K. tax in the subsequent years. The result in such a situation, under Petitioner's position in the instant case, would be that the liquidating dividend would bear no foreign tax credits at all. Perhaps even more astonishing is that, under Petitioner's view,[34] there would be no double taxation because the dividend is paid out of earnings for years in which no foreign taxes were paid, even though the actual effective rate of tax paid on the distributed earnings in aggregate would equal the combined tax rates of the two

[32] G.C.M. 36814 (Aug. 18, 1976). A General Counsel's Memorandum was, in 1976, an internal document expressing the legal opinion of the Interpretative Division in the IRS Office of Chief Counsel. Subsequent litigation compelled the disclosure of these documents.

[33] Under section 367(b) and the temporary regulations thereunder, a liquidating distribution is treated as a dividend for U.S. purposes to the extent of the subsidiary's earnings and profits. Temp. Treas. Reg. § 7.367(b)-5.

[34] Pet. Br. at 46.

countries. To determine the existence of double taxation solely with reference to the laws of the U.S. assumes away the possibility of double taxation and totally defeats the Congressional purpose underlying section 902.

G.C.M. 36814 was in full agreement. The case of the liquidating dividend, according to G.C.M. 36814, was illustrative of—

> the inequitable and discriminatory position the taxpayer is placed in where the Service fails to make an adjustment to the ordering rules to correlate the foreign taxable income that produced the foreign tax with the foreign taxable income that is the source of the dividend distribution.

G.C.M. 36814 concluded that "an interpretation of Code § 902 that would permit this result would conflict with the legislative purpose of that section as well as being logically indefensible." Because Petitioner insists that foreign tax law is irrelevant in connection with section 902, Petitioner would have this Court uphold this "logically indefensible" scheme in the present case.

The solution proposed in G.C.M. 36814 was to allocate the loss (deficit) of the intervening year first *according to U.K. tax law rules*. The result would be that U.S. earnings and profits would be sourced in the same years as the U.K. taxes imposed on them, and the purpose of section 902 thus would be accomplished.

However, instead of adopting such a solution, the IRS has rejected G.C.M. 36814 in favor of continued rigid adherence to U.S. tax law ordering concepts.[35] The IRS would disingenuously dismiss the anomaly described in G.C.M. 36814 as "one of the many aspects of foreign law which affect the effective rate of foreign tax."[36]

[35] Rev. Rul. 87-72, 1987-2 C.B. 170.

[36] *Id.*

II. TOTAL DISREGARD OF FOREIGN LAW IN COMPUTING "ACCUMULATED PROFITS" WOULD CAUSE DOUBLE TAXATION AND LEAD TO ANOMALOUS RESULTS.

Petitioner's fundamental argument is that foreign law concepts of taxable income have "no bearing" on the application of the section 902 formula[37] and, therefore, must be disregarded. According to Petitioner, only by looking solely to U.S. tax concepts can the Congressional purpose be achieved: to avoid double taxation;[38] to equate the U.S. tax treatment of foreign branches with subsidiaries;[39] and, in general, to avoid "eccentric"[40] and "irrational results and disparities."[41]

Petitioner's position that U.S. tax concepts are controlling does not end with the application of U.S. ordering rules. Petitioner would have this Court hold that U.S. tax concepts control *every aspect* of the computation of accumulated profits for section 902 purposes and, in the process, give this Court's blessing to such collateral, but equally "irrational" and "eccentric" positions as the one adopted in Revenue Ruling 87-14.[42]

Revenue Ruling 87-14 addressed the application of the section 902 formula to Saudi Arabian "mixed companies," *i.e.*, companies incorporated under the laws of Saudi Arabia that are owned in part by Saudi nationals and in part by nonnationals. As the Revenue Ruling explains, under Saudi corporate tax law, corporate income tax is imposed *only* on the share of the mixed company's profits attributable to the non-Saudi shareholders. Consequently, those profits attributable to Saudi shareholders bear *no* corpo-

[37] Pet. Br. at 11. *See* Pet. Br. at 10 (denominator of formula "must be defined in terms of United States tax principles"), 14-15.

[38] Pet. Br. at 11, 14-15.

[39] Pet. Br. at 17.

[40] Pet. Br. at 22.

[41] Pet. Br. at 15.

[42] 1987-1 C.B. 181.

rate income tax, but those attributable to non-Saudi shareholders bear corporate tax at the full statutory rate.

The mixed company, which was owned 50 percent by a U.S. corporation and 50 percent by a Saudi national, had 200x in pre-Saudi corporate income tax profits for the year at issue. Under the Saudi tax law previously described, only half the profits (the non-Saudi shareholder's portion) bore Saudi corporate income tax at the Saudi statutory rate of 45 percent, resulting in 45x of corporate income tax being imposed on 100x of profits. The Revenue Ruling notes that the U.S. shareholder's share of the profits bore the *entire* Saudi corporate income tax upon distribution. Thus, on distribution of all profits, the U.S. shareholder would receive only 55x, *i.e.*, 100x in pre-tax profits less the 45x in income tax imposed on those profits.

The "sensible result"[43] on these facts should be that, under the section 902 formula, the U.S. shareholder is allowed all 45x of the Saudi corporate income tax as indirect foreign tax credits. To achieve this sensible result, however, the term "accumulated profits" in the section 902 formula must be limited to that portion of the Saudi company's profits allocable to the non-Saudi shareholder and actually subject to Saudi corporate income tax. *In other words, the accumulated profits denominator must be determined in a manner that accords due regard to the peculiarities of foreign law.*

Predictably, however, Revenue Ruling 87-14 held that the denominator must include *all* profits of the Saudi company, regardless of the fact that half of such profits bore no foreign tax. The justification: "There is nothing in either the Code or regulations" that provides for modifying the denominator of the section 902 formula to recognize the effect of foreign tax law. The result is that, when the 55x (the entire after-tax income attributable to the U.S. shareholders) is fully distributed to the U.S. shareholder, it is entitled only to 16x of the Saudi corporate income taxes

[43] *Champion Int'l Corp.*, 81 T.C. at 437.

as an indirect credit, although that 55x dividend bore all 45x of such taxes. Assuming a U.S. corporate income tax rate of 46 percent, the dividend would bear an additional 16.67x in U.S. income tax, resulting in a combined effective tax rate of almost 62 percent.[44]

The rigid position adopted by the Commissioner in Revenue Ruling 87-14 clearly results in double taxation. To avoid double taxation, profits should bear a combined tax at an effective rate no higher than the higher of the two applicable tax rates. However, the combined tax rate that results from the holding in Revenue Ruling 87-14 is almost 62 percent. By contrast, if the IRS had properly taken into account the operation of Saudi corporate tax law, the combined tax rate would have equalled the assumed U.S. rate of 46 percent—precisely the result needed to avoid double taxation.

The holding of Revenue Ruling 87-14 also destroys any possibility of realizing the legislative goal of equivalence between the taxation of a foreign branch and a foreign subsidiary. If the U.S. shareholder in Revenue Ruling 87-14 had been a partner in a Saudi partnership, rather than a shareholder in a Saudi corporation, the Saudi income tax imposed on its share of the partnership's profits would have been fully creditable for U.S. tax purposes. Thus, under the holding of the Revenue Ruling, the tax burden of the U.S. corporate investor changes dramatically if that investor chooses a foreign corporate form for its investment rather than branch form.[45] Petitioner does not con-

[44] The 55x dividend would be "grossed up" under section 78 of the Code by the 16x in allowable Saudi taxes, for total income of 71x. At 46 percent, this would result in 32.67x of U.S. taxes, or 16.67x of U.S. taxes in excess of the 16x in Saudi taxes allowed as credit. Accordingly, the 100x of pre-Saudi tax profits of the mixed company would bear 45x in Saudi tax and 16.67x in additional U.S. income tax, for a total of 61.67x of income tax on 100x of profits.

[45] Where a U.S. corporation owns an interest in a foreign partnership, such interest is treated as if it were a branch of the U.S. corporation. For instance, in Revenue Ruling 80-293, 1980-2 C.B. 128, the IRS ruled that the incorporation of a foreign partnership's assets caused a U.S.

test that section 902 requires the avoidance of such a disparity. However, Petitioner is incorrect in arguing that rigid adherence to U.S. tax concepts, and complete disregard of foreign tax law, is the proper path to foreign tax credit parity between branches and subsidiaries.[46]

Reversing the situation described in Revenue Ruling 87-14 further illustrates the "eccentric" and "irrational results and disparities" mandated by Petitioner's position. Assume foreign tax law imposed corporate tax only on that share of a company's profits attributable to a resident shareholder, and exempted from corporate tax the profits attributable to the U.S. corporate shareholder. Following Petitioner's position, the U.S. shareholder could use a portion of the foreign corporate taxes paid to offset its U.S. income taxes on a dividend, even though the profits out of which such dividends were paid did not, in fact, bear any foreign tax.[47] This would produce precisely the "substantial windfall" in the form of "phantom taxes deemed paid" which the Claims Court found opprobrious in its decision below.[48]

These "eccentric" and "irrational results and disparities" of the holding in Revenue Ruling 87-14 arise from disregarding the section 902 formula's intended purpose of properly allocating the foreign tax among the foreign corporation's shareholders. As the Tax Court stated in *Champion*, one fundamental purpose of the section 902 formula—

corporate partner to be subject to the "branch loss recapture" rule enunciated in Revenue Ruling 78-201, 1978-1 C.B. 91, in the same manner as if the U.S. corporation had incorporated a branch.

[46] Pet. Br. at 26-32.

[47] On the facts of Revenue Ruling 87-14, this would permit the U.S. shareholder to receive a dividend of 100x which, after credit for a portion of the taxes borne by the foreign shareholder's share of the profits, would bear a "residual" U.S. tax only slightly in excess of 30 percent, well below the assumed 46 percent rate.

[48] *Goodyear Tire & Rubber Co.*, 14 Cl. Ct. at 30-31.

> is to allocate to each shareholder . . . its share of the credit resulting from the taxes paid by the foreign corporation on the share of the accumulated profits received by that shareholder.[49]

This purpose can *only* be realized if the section 902 formula, particularly the term "accumulated profits," is determined by taking into account foreign tax law as necessary and appropriate in particular cases to carry out the underlying purposes of section 902, and can not possibly be realized by wholly disregarding foreign law in all cases.

In recently issued regulations, Petitioner has expressly adopted a position contrary to his position here and in Revenue Ruling 87-14. Treasury Regulations section 1.904-6(a)(1)(i) enunciates the following general principle:

> [Foreign] [t]axes are related to income if the income is included in the base upon which the tax is imposed. If, for example, foreign law exempts certain types of income from foreign taxes, . . . then no taxes are considered to be related to such income . . . .

This regulation explicitly recognizes the critical connection between foreign taxes and the income on which such taxes are imposed, and redefines that income to exclude income not taxed under foreign tax law, notwithstanding that such income, under U.S. tax concepts, would be fully taxable.

Treasury Regulations section 1.904-6(b)(2) elaborates on that general principle by providing:

> If a taxpayer receives or accrues a dividend from a noncontrolled section 902 corporation, and if the Commissioner establishes that there is an agreement, express or implied, that such dividend is paid out of a designated pool of earnings of the foreign corporation, then only the foreign

[49] *Champion Int'l Corp.*, 81 T.C. at 437.

taxes imposed on that pool of earnings will be considered to be taxes related to the dividend.[50]

This latter rule would apply to the situation in Revenue Ruling 87-14 to reverse the holding therein, unless the Commissioner takes the position that no "express or implied" agreement exists in that case, because the pool of earnings is created by foreign tax law. Simply put, Petitioner has effectively admitted through these regulations, contrary to its position in this case,[51] that foreign tax law has a necessary and critical relationship to the determination of the "accumulated profits" amount to be used in the section 902 formula.

Significantly, Petitioner—again, contrary to its position in this case and in Revenue Ruling 87-14—has also taken U.K. tax law into account in interpreting "accumulated profits" for section 902 purposes in the context of the U.K.-U.S. Tax Treaty (the "Treaty").[52] Under U.K. law, an "advance corporation tax" ("ACT") is levied on the profits of a U.K. corporation. Under the Treaty, U.S. corporate shareholders in a U.K. corporation are entitled to a partial refund of the ACT on distributed dividends.[53] The unrefunded balance is treated, under the Treaty, as a tax imposed on the distributing U.K. corporation.[54] Accordingly, such unrefunded portion is eligible for credit as a tax deemed paid by the U.S. shareholder under section 902.

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[50] Although the quoted regulations provisions were not in effect for the years were at issue, they do not purport to interpret any intervening amendment to section 902.

[51] Pet. Br. at 32-34.

[52] Convention Between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital, Dec. 31, 1975, *reprinted in* III Tax Treaties (PH) ¶ 89,030-59.

[53] *Id.* at art. 10(2)(a)(i).

[54] *Id.* at art. 23(1)(c).

However, calculating the "accumulated profits" in the section 902 formula solely by reference to U.S. tax concepts would result in understating the deemed paid credit for the unrefunded ACT where there are both U.S. and third country shareholders of the U.K. corporation. The Treasury Department promulgated rules as part of its technical explanation of the Treaty ("Technical Explanation")[55] to deal with this problem. Significantly, these rules *exclude from the term "accumulated profits" profits of the U.K. corporation that would otherwise be included under U.S. tax concepts.*

According to the Technical Explanation of Article 23 of the Treaty, where a U.S. corporation owns less than all of the stock of a U.K. corporation, the section 902 credit must be calculated

> with reference solely to the proportionate interest in accumulated profits attributable to the United States shareholder. Thus, for example, the ratio which the distribution to the United States shareholder bears to accumulated profits in excess of income taxes . . . will be calculated as if the United States shareholder's proportionate interest in accumulated profits were the entire accumulated profits of a corporation of which it was the sole owner.

The Technical Explanation then provides an example involving a 25 percent U.S. corporate shareholder, and uses as "accumulated profits" in the section 902 formula *not* the entire $400 of the U.K. corporation's profits, but rather the U.S. shareholder's proportionate interest in those pretax profits—$100. The example concludes:

> Quite often the shares of a United Kingdom corporation are owned by both United States and foreign shareholders. In these cases, payment of

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[55] Amended Treasury Department Technical Explanation of U.S.-U.K. Income Tax Treaty (October 25, 1979), *reprinted in* III Tax Treaties (PH) ¶ 89,064.

an ACT credit to the United States shareholders will require a separate computation of earnings and profits for United States tax purposes which reflects that shareholder's proportionate interest in the corporation.

Thus, the Technical Explanation modifies the term "accumulated profits" to take into account properly the operation and effect of foreign tax law, and to avoid the "skewed result" that would follow from the rigid application of U.S. tax concepts advocated in the instant case. Moreover, since the Treaty is silent on this point, there can be no question that this solution flows from an interpretation of the statutory language of section 902. Simply put, if the stated rationale of Rev. Rul. 87-14 were correct, there would be no grounds to support the positions taken in either the Technical Explanation or the section 904 regulations.

III. PETITIONER IS WRONG IN ARGUING THAT THE COURTS, OR INDEED CONGRESS AND TREASURY, ARE INCAPABLE OF PROPERLY TAKING INTO ACCOUNT FOREIGN LAW WHEN NECESSARY TO PREVENT DOUBLE TAXATION.

Petitioner argues that taking into account foreign law in determining the indirect foreign tax credit would expose such determinations to the "vagaries of foreign tax law," requiring the courts to apply "unfamiliar [foreign] tax principles" that may be "difficult to ascertain" and "profoundly different" from U.S. tax laws. In Petitioner's view, "burdensome litigation" would result, jeopardizing the "fair administration" of the indirect credit; the inability of U.S. courts to determine foreign law would cause "troublesome and unwarranted interference with the proper administration of the statute." This chamber of horrors, according to Petitioner, can be laid at the feet of those courts which, like the Court of Appeals below, would ignore the "teaching" of *Biddle*.[56] Apparently, Petitioner mistakenly believes

[56] Pet. Br. at 40-41 & n.18.

that the "teaching" of *Biddle* is to disregard foreign tax law.

Petitioner's invitation to concede judicial incapacity where foreign tax law is concerned should be rejected summarily. This Court in *Biddle* did take foreign tax law into account to determine that a U.S. shareholder was not the person who "paid" the foreign tax. When, "by express language or necessary implication,"[57] the courts have been called on to take into consideration foreign tax law so as to mesh it with U.S. law, the courts have not hesitated to do so. This has often occurred in the foreign tax credit area.

Petitioner has stressed that the foregoing problems are "compounded" where the tax laws of several foreign jurisdictions are involved.[58] But in *Bank of America National Trust and Savings Association v. United States*,[59] the Court of Claims considered whether certain taxes that the taxpayer paid in Argentina, the Philippines and Thailand were income taxes and thus creditable under the foreign tax credit provisions. The court measured the substantive provisions of the respective foreign tax laws against the established benchmark of "United States concepts" of "income taxes."[60] The Court of Claims did not hesitate to

[57] *Biddle v. Commissioner*, 302 U.S. at 578.

[58] Pet. Br. at 41 n.18.

[59] 198 Ct. Cl. 263, 459 F.2d 513 (Ct. Cl. 1972), *cert. denied*, 409 U.S. 949 (1972).

[60] The court noted the "consensus" that "the United States notion of income taxes furnishes the controlling guide," in that under established precedent, "the question of whether a foreign tax is an 'income tax' within § 901(b)(1) must be decided under criteria established by our revenue laws and court decisions, and . . . the foreign tax must be the substantial equivalent of an income tax as that term is understood in the United States." *Bank of Am. Nat'l Trust and Sav. Ass'n*, 459 F.2d at 515, 517. Thus, the Court of Claims, avoiding a blind application of an overbroad or universal rule of "United States law" or "foreign law" to the notion of "creditability," carefully measured and analyzed the substantive provisions of the foreign tax laws, in light of a specific, judicially-identified guideline. *See Bank of Am. Nat'l Trust and Sav.*

receive evidence on the provisions of multiple foreign tax laws in that case, and, indeed, such task cannot be avoided in determining whether a foreign tax is an "income tax" for purposes of the foreign tax credit.[61]

Courts have also considered foreign law in determining, with respect to the credit for foreign taxes, whether the taxpayer is legally liable under foreign law for the tax.[62] In *Nissho Iwai American Corporation v. Commissioner*,[63] the taxpayer claimed a credit for certain Brazilian withholding taxes on interest. The Tax Court noted that "[a] foreign tax is creditable only if the taxpayer is legally liable under foreign law for the tax." Accordingly, the court reviewed translations of the applicable Brazilian tax law and found that the taxpayer was legally liable under Brazilian law for the Brazilian withholding tax.[64]

Ass'n, 459 F.2d at 517-518; *compare Goodyear Tire & Rubber Co.*, 14 Cl. Ct. at 28.

[61] Courts have frequently ascertained foreign tax law for this purpose, including the laws of many diverse countries. *See, e.g., Bank of Am. Nat'l Trust and Sav. Ass'n.*, 61 T.C. 752, 755-759 (1974), *aff'd unpublished opinion* (9th Cir. Feb. 25, 1976) (Thailand); *Morrison-Knudsen Co., Inc. v. United States*, 68-2 U.S.T.C. ¶ 9612 (N.D. Cal. 1968) (Afghanistan); *Abbot Laboratories Int'l Co. v. United States*, 160 F. Supp. 321 (N.D. Ill. 1958), *aff'd per curiam*, 267 F.2d 940 (7th Cir. 1959) (Colombia); *Guantanamo & W. R.R. Co. v. Commissioner*, 31 T.C. 842 (1959), *acq.*, 1959-2 C.B. 4 (Cuba); *New York & Honduras Rosario Mining Co. v. Commissioner*, 168 F.2d 745 (2d Cir. 1948) (Honduras); *Chicago Burlington & Quincy R.R. Co. v. United States*, 197 Ct. Cl. 264, 455 F.2d 993 (Ct. Cl. 1972), *rev'd*, 412 U.S. 401 (1973) (subsequent history omitted) (Mexico); *Brantman v. United States*, 167 F. Supp. 885 (N.D. Calif. 1958) (Singapore).

[62] *Nissho Iwai Am. Corp. v. Commissioner*, 89 T.C. 765, 773 (1987); *Continental Illinois Corp. v. Commissioner*, T.C. Memo. 1988-318, 55 T.C.M. (CCH) 1325, 1330 (1988). Indeed, Petitioner's own Treasury regulations reflect the standard of legal liability that appears in case law and rulings, that the person considered as paying or accruing a foreign tax for purposes of sections 901 and 903 is "the person on whom foreign law imposes legal liability for such tax." Treas. Reg. § 1.901-2(f)(1).

[63] 89 T.C. 765 (1987).

[64] 89 T.C. at 773-774. Thus, the court effectively meshed the requisite

Similarly, in *Burns v. Commissioner*,[65] various partners claimed credits for certain British and Canadian taxes that had been accrued in respect of their partnership. The court examined provisions of British law to determine whether the British taxes were obligations of a partnership, or of the individual partners. Further, in *Gleason Works v. Commissioner*,[66] the Tax Court considered the peculiarities of the British tax system in relation to certain interest payments, and held that the creditor was entitled to the credit because the foreign tax fell in substance upon the creditor's income.[67]

Even the Commissioner, in his own Treasury Regulations, has required foreign law to be taken into account in determining whether the requirements are met for the creditability of a foreign tax.[68] Indeed, the Treasury Reg-

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foreign tax law considerations for determining the legal liability for tax, with the more general benchmark of "U.S. tax law" as the "standard" for deciding whether a foreign levy is a "creditable income tax."

[65] 12 B.T.A. 1209 (1928), *acq.*, VII-2 C.B. 3, 6.

[66] 58 T.C. 464 (1972).

[67] Indeed, *Gleason Works* followed several cases, including *Biddle, supra*, in which courts examined British law to resolve the foreign tax credit issues. *See, e.g., Trico Products Corp. v. Commissioner*, 46 B.T.A. 346 (1942); *Irving Air Chute Co. v. Commissioner*, 1 T.C. 880 (1943), *aff'd*, 143 F.2d 256 (2d Cir. 1944).

[68] Treas. Reg. § 1.901-2(b)(2)(ii) (foreign corporation considered to meet the realization requirement if the tax is imposed with respect to deemed distributions of amounts that meet the requirement in the hands of the person that, under foreign law, is deemed to distribute the amount); Treas. Reg. § 1.901-2(b)(4)(i) and (ii) (principles used in the foreign tax law to attribute costs and expenses to gross receipts may be reasonable even if they differ from principles that apply under the Code); Treas. Reg. § 1.901-2(e)(4)(i) (foreign law considered in determining whether a taxpayer's tentative "first levy" liability is or can be reduced by a "second levy" liability); Treas. Reg. § 1.901-3 (in connection with determining the amount of tax on foreign mineral income, such income is to be reduced by any credits, expenses, losses, and other deductions which are properly allocable to such income under the law of the foreign country); Treas. Reg. § 1.901-2A(e)(2) (for purposes of a safe harbor formula, gross receipts and costs and expenses are those determined under applicable foreign law); Treas. Reg. § 1.901-2(e)(5)(i) (amounts

ulations under section 904 mandate that foreign law be taken into account with respect to: (i) determinations of the source of income from certain foreign qualified business units ("QBU");[69] (ii) the effect on the limitation of reductions of foreign tax rates on distributions of income;[70] (iii) certain allocations of taxes to separate categories of income;[71] and (iv) the apportionment of foreign taxes that relate to more than one separate category of income.[72]

In summary, foreign law considerations necessarily occupy a significant place in our federal tax laws, and particularly as regards the foreign tax credit. The legislative histories of successive variations of the foreign tax credit provisions reveal consistent and unequivocal Congressional recognition of this fact.[73] Congress, the courts, and even

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paid are not compulsory payments, and thus are not amounts of tax paid, to the extent they exceed the amounts of tax liability under foreign law) (amounts paid do not exceed the amount under foreign law, if the taxpayer determines the amount consistently with reasonable interpretations and applications of the substantive and procedural provisions of foreign law); Treas. Reg. § 1.901-2(f)(3) (taxes paid are allocated based on the tax attributable to each spouse's share of the tax base under foreign law); Temp. Treas. Reg. § 1.905-3T(b)(1) (determinations of accrued and unpaid foreign tax liabilities denominated in foreign currency, as determined under foreign law).

[69] Treas. Reg. § 1.904-4(c)(4)(iii) (income determined to be from sources within or without the QBU's country of operation under the laws of the foreign country of the income payor).

[70] Treas. Reg. § 1.904-4(c)(7)(i) and (ii) (effective rate of tax imposed on a foreign corporation's income is reduced under foreign law upon distributing such income).

[71] Treas. Reg. § 1.904-6(a)(1)(i) (if foreign law exempts certain types of income from foreign taxes, then no taxes are "related" to the separate category).

[72] Treas. Reg. § 1.904-6(a)(1)(ii) (for purposes of apportioning foreign taxes among separate categories, gross income is determined under the law of the foreign country or United States possession to which the foreign income taxes were paid or accrued).

[73] For example, in connection with revisions to the foreign tax credit in the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No.

Petitioner have seen fit to incorporate, analyze, and apply foreign laws within the federal scheme of taxation. Accordingly, this Court must summarily reject Petitioner's misguided plea for a mandatory, judicially-imposed exclusionary rule with respect to foreign law.

CONCLUSION

For the foregoing reasons, this Court should not hold, as Petitioner urges, that foreign tax law may *never* be taken into account in determining what constitutes "accumulated profits" for purposes of the section 902 indirect foreign tax credit. Rather, this Court, in its holding in this case, should recognize that foreign tax law must be taken into account to achieve Congress' purpose in enacting the indirect foreign tax credit, that is, *to prevent double taxation.*

Respectfully submitted,

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September 5, 1989

97-248, 96 Stat. 324, Congress stated:

> In determining the amount of taxes which are creditable, the Secretary would take into account the deemed foreign law deduction . . . .

S. Rep. No. 404, 97th Cong., 2d Sess. 1523 (1988). For additional examples, see Staff, Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986* 853-854 (J. Comm. Print 1987).